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UNITED STATES OF AMERICA
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Statutory Review of the System for Regulating Rates and Classes for Market Dominant Products	Docket No. RM2017-3

REPLY COMMENTS OF
THE AMERICAN CATALOG MAILERS ASSOCIATION, INC. (ACMA) AND
THE PARCEL SHIPPERS ASSOCIATION (PSA)
(March 30, 2018)

Pursuant to Order No. 4258,[1] the American Catalog Mailers Association and the Parcel Shippers Association respectfully submit these comments in reply to the initial comments of Valpak Direct Marketing Systems, Inc. and the Valpak Franchise Association, Inc.[2] (Valpak).

[1] Notice of Proposed Rulemaking for the System of Regulating Rates and Classes for Market Dominant Products, December 1, 2017 (Order No. 4258).

[2] Valpak Direct Marketing Systems, Inc. and the Valpak Franchise Association, Inc. Initial Comments on the Notice of Proposed Rulemaking for the System for Regulating Rates and Classes for Market Dominant Products, March 1, 2018, (Valpak Comments).

I. INTRODUCTION.

Our initial comments opposed the surcharge on Marketing Mail Flats ("Flats") and explained why one is not required, may harm rather than help the financial position of the Postal Service, and unnecessarily intrudes on management's pricing flexibility.[3] Valpak expresses support for the surcharge and argues that it should be higher.[4]

Valpak's arguments fail, by suggesting that individual products are required to be profitable, by failing to show that Flats as defined is a category that warrants the attention it is being given, and by focusing narrowly on Flats cost coverage to the exclusion of all else. It makes no showing that the pricing it advocates would be expected to improve Postal Service finances or that the existing pricing threatens the Service's financial integrity. It characterizes as "not inconsiderable" the pricing flexibility of the Postal Service that the "PAEA was designed to give," and then supports transferring flexibility from the Postal Service to the Commission.[5]

Valpak sees "subsidies flowing" and cites itself as saying that, but for unprofitable

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[3] *See* Comments of the American Catalog Mailers Association and the Parcel Shippers Association, March 1, 2018 at 4-18 (ACMA PSA Comments).

[4] Valpak Comments at 4, 8.

[5] Valpak Comments at 2 ("On the other hand, PAEA was designed to give a measure of pricing flexibility to the Postal Service — greater in the area of competitive products, but not inconsiderable with respect to market dominant products — while diminishing the pricing responsibility of the Commission, except to correct illegal pricing.").

products, the exigency case would not “have been necessary.”[6] Saying that is not just an exaggeration, it is wrong. At best it reveals erroneous thinking. Whatever the direction of the effect, adjusting a rate under a cap will not have a meaningfully large influence on net income. By analyzing contributions, our initial comments showed the mechanics of estimating this effect. ACMA PSA Comments at 11-14.

Categories are designated as products on sundry bases.[7] In matters relating to the cost coverages reported for them, the “totality of circumstances presented” must be considered.[8] ACMA has outlined multitudinous circumstances, and Valpak has neglected them.

II. THERE IS NO REQUIREMENT THAT EACH INDIVIDUAL PRODUCT MUST COVER ITS ATTRIBUTABLE COSTS.

Valpak appears to be of the view that statutory Factor 2, 39 U.S.C. 3622(c)(2), requires that each individual product *must* cover its attributable costs, inferring that the

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[6] Valpak Comments at 13, citing Valpak initial comments in Docket No. ACR2013, January 31, 2014. Valpak’s perspective on subsidies in the private sector may not be well developed. At 13 Valpak says that “private sector businesses do not penalize their best customers … to subsidize [unprofitable customers].” We agree that they might not penalize (Valpak’s term for increasing prices) them for this reason, but they very well might penalize them in order to increase their profits. In fact, private sector firms that do not search continually for profit opportunities are not likely to survive long.

[7] *See* Docket No. RM2009-3, Order No. 536, September 14, 2010 at 22 (“The definition of the term ‘product’ in section 102(6) is so general (‘a postal service with a distinct cost or market characteristic’) that almost any category of mail nominated would qualify.”).

[8] *See* Order No. 1427 at 4.

Commission has no choice in this matter.[9]

The question of whether the Commission *may* or *must* order corrective action for non-compensatory products has been litigated extensively.[10] It is now accepted that the Commission *may* order corrective action, if an assessment of the overall situation supports it, but is not *required* by Factor 2 to do so. That is, the Commission agrees that section 3622(c)(2), although it is the principal factor relating to cost coverages, does not itself require that categories designated as products cover their attributable costs.[11] We noted this in our initial comments.[12]

III. TO REACH ANY RECOMMENDATION RELATING TO WHETHER FLATS RATES ARE JUST AND REASONABLE AND FAIR AND EQUITABLE, VALPAK AND THE COMMISSION SHOULD CONSIDER A BROADER RANGE OF CIRCUMSTANCES THAN VALPAK'S MICRO-FOCUS SEES.

Objective 8, 39 U.S.C. 3622(b)(8), which is to be considered in conjunction with the other objectives and the factors, requires that the regulatory system be designed to bring about rates that are "just and reasonable." In Order No. 4257, the Commission explains that "a system achieving *just* rates requires that the amount charged for each

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[9] *See* Valpak Comments at 14 ("the requirement that each class or type of mail service, including each product, bear its attributable costs (Factor 2)" (footnote omitted)). But, the phrase "including each product" does not appear in Factor 2. *See* 39 U,S.C. 3622(c)(2).

[10] *See* pp 5-6 below.

[11] As the Commission notes, this interpretation "is made all the more plain by the fact that ten market-dominant products did not cover their costs in fiscal year 2010, and yet the Commission did not hold that rates for any products other than Standard Mail Flats were not in compliance with the PAEA." Brief for Respondent, U.S. Court of Appeals for the District of Columbia, Case No. 11-1117, November. 23, 2011, at 29.

[12] *See* ACMA PSA Comments at 4-5

service is not excessive to the mailer … [and] concludes that the system *has* maintained just rates." Order No, 4257 at 117-18 (emphasis added).[13] Further on, in a section analyzing "Product-Level Contribution," "the Commission determine[d] that the rates [for non-compensatory] products were not *reasonable because* they threatened the financial integrity of the Postal Service." Order No. 4257 at 233, 235 (emphasis added).[14]

Therefore, it is a matter of considerable importance whether the rates for Flats are "threaten[ing] the financial integrity of the Postal Service." This question is of central importance to Factor 8 ("just and reasonable schedule") and Factor 5 ("to assure adequate revenue"). And Factor 4 ("pricing flexibility" for the Postal Service) is also at issue. *See* 39 U.S.C. 3622(b)(4), (5) and (8).

Valpak, citing various Commissions findings, takes the position that the rates for underwater products are bad *per se*, and therefore unreasonable. Valpak Comments at 4, 14, 16. However, in a proceeding focused, as this one is, on financial integrity, indeed on financial difficulties that are quantified in billions of dollars, it is inherent that the badness of the rates of non-compensatory products, however bad they might appear to a casual observer, hinges on whether, in this case, the rates for Flats are really a *non-de minimis* cause of those financial difficulties. As explained in our initial comments, we believe that, properly viewed, they are not. Flats is reasonably priced,

[13] Order on the Findings and Determination of the 39 U.S.C. § 3622 Review (Order No. 4257).

[14] *See also* Order No. 4257 at 228 ("Commission also analyzes whether rates have been reasonable (i.e., whether they have threatened the financial integrity of the Postal Service)").

and its prices have not threatened, and are not jeopardizing, the financial integrity of the Postal Service. We also believe that if the Commission substitutes its judgement on this matter for that of the Postal Service, it will likely find that the remedy proposed for Flats will itself threaten the financial integrity of the Postal Service.

On another point, Valpak laments that the cost coverage of its mail is high and wonders why it is declining. Valpak Comments at 14-17, 19. It states that its markup is "137.5 percent" higher than Flats. *Id.* at 17. It means percentage points higher. But this is misleading even if corrected, because the two percentages have different bases. It is well understood that highly workshared mail tends, basically by construction, to have high coverages. Valpak does not mention this. It shows in its Table III that the base cost for its mail is 7.3 cents but does not mention that the base cost for Flats is a whopping, and well-nigh unbelievable, 52.0 cents. Neither does it mention that the rate it pays is only 15.8 cents per piece, though, with DPS processing, its mail is likely processed in the same way as several other categories with higher rates. *Id.* at 16.

In Docket No. ACR2010, the Commission reviewed Flats and the non-compensatory question, and found that, under section 101(d), the associated rates were not "established … on a fair and equitable basis." 39 U.S.C.101(d)). On appeal, the D.C. Circuit Court viewed that section as providing "failsafe protection" that could be "invoke[d] …, "at least in extreme circumstances," and remanded the case for clarification of what those circumstances might be.[15] On remand, the Commission dug

[15] *United States Postal Service v. Postal Regulatory Commission,* 676 F.3d 1105 at 1106 (D.C. Cir. 2012) (USPS v. PRC).

more deeply into the below-cost matter and explained generally that considerations must recognize the "totality of circumstances presented."[16] Valpak does the opposite by focusing only on cost coverage. Flats as a category is more limited now than in 2010, and many circumstances have changed. As recently as its initial comments in Docket No. ACR2017, ACMA has discussed a range of circumstances that are relevant, and Valpak has neglected them.

A first step in considering with greater perspective is to recognize that Flats is a declining category whose makeup in 2017 is notably different from that in 2010. Nonprofit volume, which receives much lower rates than Commercial, is now 30.1 percent of Commercial volume, up from 23.0 percent.[17] This alone explains a significant drop in cost coverage. Flats volume is down 29.9%. Flats is now 6.3 percent of the Marketing Mail class, down from 8.5 percent. If one looks at Quarter 1 of 2018, Flats is down 41.0 percent from Quarter 1 of 2010, and is only 5.5 percent of the Marketing Mail class. The situation is quite different.

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[16] Docket No. ACR2010-R, Order No. 1427, at 4 (August 9, 2012).

[17] The effects of changes in Nonprofit volume can be significant. Here is an example involving a period shorter than 2010 to 2017. For 2017 relative to 2016, for Flats and Carrier Route combined, Nonprofit volume *increased* 2.66 percent and Commercial volume *decreased* 6.73 percent. In its 2017 ACD, at 58, the Commission focuses on this combination and notes that the "combined unit revenue decreased 3.1 percent and [the] combined unit cost increased 1.5 percent." If Nonprofit volume had not grown relative to Commercial, both the decrease in unit revenue and the increase in unit cost would have been notably smaller, changing the comparison in meaningful degree.

A more reasonable category for rate review is the Flats/CR combo.[18] It relates in a more meaningful way to markets and to many of the decisions mailers make. Excluding the Nonprofit categories, the cost coverage of it is about 100 percent, not impressively high but certainly not an "extreme circumstance." In the words of section 101(d), again, the question becomes whether the rates within the combo are "fair and equitable." If they are, as we think, then Valpak's concern distils to an argument that the Nonprofit rates are too low and that the Commission should play watchdog for categories within.

Contrary to what Valpak infers, it is not uncommon, however, or necessarily bad, for categories within other categories to be below cost. Within First-Class Mail, for example, considerable portions of the mail to and from Guam, Hawaii, Alaska, the Alaskan bush, the Grand Canyon, and some expanses of Wyoming are likely below cost. Also, "free" services exist, such as plant load, management of the address system, forwarding, mail hold, collection of postage due, returns as undeliverable, and ZIP Code lookup. As a residual category that is declining, Flats should be accorded similar consideration. Some flexibility for the Postal Service is warranted.

[18] This somewhat arbitrary grouping represents some but not all catalog mail use. Other, even higher contribution, categories might be included to ascertain the segment's "desirability" from a financial perspective. We believe that reviewing customer segment profitability is a more useful measure of the financial impact of various mailers than subjectively selecting one or another "products" they use.

ACMA and PSA, as well as the Postal Service, have explained other circumstances that inform perspective on the Flats question, all of which Valpak is either unaware of or has failed to acknowledge. For example:[19]

> 1. For two decades running, the cost increases reported for Flats have been inexplicably large, raising serious questions about their reliability, whether they are incurred efficiently, whether they are good indicators of actual cost responses to volume changes, and whether it is fair to view them as caused by the mail at issue. The Commission has shared these concerns, as evidenced by its Chapter 6 in the 2015 ACD and its recently-initiated Docket No. RM2018-1.
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> 2. Whether it is the case that the rates for Flats are above stand-alone costs, at least for the major portion of the United States, not just for high-volume pockets, and therefore whether it is unfair to the mailers involved to lock them into a system and argue for even higher rates. *See in particular* ACMA Initial Comments, Docket No. ACR2015.
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> 3. Whether it is the case that Flats rates are now high enough that, especially if given supplemental increases, the mailers involved will begin, if they have not already, dropping addresses in low density, low income, rural, and other low volume areas, in small towns but also in some large ones, meaning that the addresses there will have added difficulty participating in the flow of goods and services the economy is prepared to offer and may have universal service but no volume.
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> 4. Whether it is the case that some mailers make mailing decisions on weighted averages of Flats and CR rates, so that a supplemental increase for Flats will reduce the volume in both categories.
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> 5. Whether it is the case, as mailing models of many catalog mailers have shown, that the own-price elasticity of catalogs, and thus in considerable degree of Flats, is much higher (in absolute value) than the econometric models of the Postal Service have been able to infer, and whether the role of cross-elasticities, about which no quantitative information is available, is much larger than we know.

[19] *See generally* ACMA PSA Comments.

6. Whether it is the case, as seems suggested by recent costing results, that further loss of Flats volume will cause the loss of scale economies and result in higher costs for the upstream portion of the Postal Service network that remains.

7. The extent to which it is important that multiplier effects are associated with catalog volume, including parcels, which is profitable to the Postal Service.

8. Whether it would be counterproductive to impose further rate increases on Flats. *See* USPS Notice of Market-Dominant Price Adjustment, Docket No. R2013-1 (Oct. 11, 2012), pp. 20ff.

9. And, particularly pertinent to this case and the Commission's concerns, whether a basis exists for expecting an increase in Postal Service net income, particularly on a longer-term basis, from surcharges on Flats, partly because it is unwise to use cap space on products in autonomous decline. We addressed this in our initial comments.

A conclusion cannot be avoided that Flats rates do not threaten the financial integrity of the Postal Service. Supplemental rate increases for Flats are unlikely to add in meaningful degree, if at all, to the Postal Service's net income, and thus they would not improve the Service's financial predicament. The totality of circumstances argues against supplemental rate increases for Flats and for flexibility for the Postal Service.

Respectfully submitted,

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